

Below is an Opinion of the Court.


RANDALL L. DUNN
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	
)	Bankruptcy Case
ROWE SANDERSON III,)	No. 09-38818-rld7
)	
Debtor.)	
_____)	
)	
HANK AND DOLLY WILLMS,)	
)	Adv. Proc. No. 10-03071-rld
Plaintiffs,)	
)	
v.)	
)	MEMORANDUM OPINION
ROWE SANDERSON III,)	
)	
Defendant.)	
_____)	

On October 4, 2010, trial ("Trial") proceeded in Hank and Dolly Willms' (collectively, "Willms") adversary proceeding ("Adversary Proceeding") against Rowe Sanderson III ("Sanderson") to except the Willms' claim against Sanderson for \$550,000 plus interest from Sanderson's discharge, based on Sanderson's alleged fraud. Following the presentation of evidence, I made oral findings and conclusions on the record and found in favor of the Willms. Before a judgment was entered,

1 Sanderson filed a "Motion of Defendant for New Trial, BR 9023, FRCP 59;
2 Motion to Reopen Case and for Reconsideration; Motion to Amend Findings
3 BR 7052, FRCP 52" ("Reconsideration Motion"). Following two
4 status/scheduling hearings and the parties' submission of further
5 memoranda and evidence in the forms of affidavits, authenticated exhibits
6 and deposition testimony of Ms. Libby Hervey, I am closing the record.
7 Based upon the entire record of the Trial and the subsequent evidentiary
8 submissions of the parties, I am prepared to announce a decision on the
9 Reconsideration Motion.

10 In deciding this matter, I have considered carefully a) the
11 testimony presented and the exhibits admitted at the Trial, and b) the
12 parties' legal memoranda and evidentiary submissions presented subsequent
13 to the Trial. In addition, I have taken judicial notice of the dockets
14 and documents filed in this Adversary Proceeding and in Sanderson's main
15 chapter 7 case no. 09-38818-rld. Federal Rule of Evidence 201; In re
16 Butts, 350 B.R. 12, 14 n.1 (Bankr. E.D. Pa. 2006). In light of that
17 consideration, this Memorandum Opinion sets forth the Court's final
18 findings of fact and conclusions of law under Federal Rule of Civil
19 Procedure 52(a), applicable in this Adversary Proceeding under Federal
20 Rule of Bankruptcy Procedure 7052.¹

21 My ultimate conclusion is that the Reconsideration Motion is
22 well taken, and I am prepared to reverse the determination that I made at
23 the Trial and enter a judgment of dismissal in favor of Sanderson. My

24
25 ¹ Hereafter, unless otherwise indicated, all chapter, section and
26 rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to
the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. The Federal
Rules of Civil Procedure are referred to as Civil Rules.

1 reasons follow.

2 I. General Standards in Exception to Discharge Litigation

3 One of the primary objectives of the Bankruptcy Code is to
4 provide a fresh start for debtors overburdened by debts that they cannot
5 pay. Snoke v. Riso (In re Riso), 978 F.2d 1151, 1154 (9th Cir. 1992);
6 Toys "R" Us, Inc. v. Esgro, Inc. (In re Esgro, Inc.), 645 F.2d 794, 798
7 (9th Cir. 1981). Accordingly, the statutory exceptions to discharge are
8 construed strictly in favor of the debtor and strictly against those
9 seeking to except debts from the debtor's discharge. See, e.g., In re
10 Riso, 978 F.2d at 1154; First Beverly Bank v. Adeeb (In re Adeeb), 787
11 F.2d 1339, 1342 (9th Cir. 1986); Devers v. Bank of Sheridan, Mont. (In re
12 Devers), 759 F.2d 751, 754 (9th Cir. 1985).²

13 The Willms' complaint ("Complaint") in this Adversary
14 Proceeding states a claim for relief under § 523(a)(2)(A) for money
15 obtained by "false pretenses, a false representation, or actual fraud."
16 The Willms bear the burden of proof to establish each element of their
17 claim for relief by a preponderance of the evidence. See Grogan v.
18 Garner, 498 U.S. 279 (1991); In re Adeeb, 787 F.2d at 1342. The parties
19 do not disagree as to the elements required to establish an exception to
20 discharge claim for fraud under § 523(a)(2)(A):

21
22 ² In his main case, Sanderson waived his discharge in order to
23 settle an adversary proceeding filed by the United States Trustee to deny
24 him a discharge. See the dockets in case nos. 09-38818-rld7 and 10-3110-
25 rld, particularly Docket No. 74, entered on October 5, 2010, in case no.
26 09-38818-rld7. However, in spite of Sanderson's waiver of his discharge,
the same principles apply when determining whether it is appropriate to
pile on an additional \$550,000 plus of nondischargeable debt, based on
alleged fraud, where liability for the debt is at issue.

1 (1) the debtor made a representation [to the
2 creditor];
3 (2) at the time debtor knew the representation was
4 false;
5 (3) debtor made the representation with the intention
6 and purpose of deceiving the creditor;
7 (4) the creditor justifiably relied on the
8 representation;
9 (5) the creditor sustained damage as the proximate
10 result of the representation's having been made.

11 Mandalay Resort Group v. Miller (In re Miller), 310 B.R. 185, 194 (Bankr.
12 C.D. Cal. 2004). See Turtle Rock Meadows Homeowners Ass'n v. Slyman
13 (In re Slyman), 234 F.3d 1081, 1085 (9th Cir. 2000).

14 The parties do disagree as to whether Sanderson can be held
15 liable for money received by Sanderson's corporate affiliate, the
16 Sanderson Company, without piercing the corporate veil. However,
17 personal benefit is not required to except a debt based on the debtor's
18 fraud from discharge.

19 Courts once limited the application of § 523(a)(2)(A)
20 to situations in which the debtor received a benefit
21 from his or her fraudulent activity. See Muegler v.
22 Bening, 413 F.3d 980, 983 (9th Cir. 2005) (citing
23 cases). However, in Cohen v. De la Cruz, the Supreme
24 Court held that the reach of § 523(a)(2)(A) is not
25 limited to the amount of benefit received by the
26 debtor. Rather, § 523(a)(2)(A) "prevents the
discharge of all liability arising from fraud." 523
U.S. at 215 . . . Following Cohen, we have concluded
that there is no requirement that the debtor "have
received a direct or indirect benefit from his or her
fraudulent activity in order to make out a violation
of § 523(a)(2)(A)." Muegler, 413 F.3d at 983-84.
Other circuits have held similarly. (citations
omitted)

27 Ghomeshi v. Sabban (In re Sabban), 600 F.3d 1219, 1222-23 (9th Cir.
28 2010).

29 Recognizing the reality that few debtors are likely to break

1 down and confess to fraud on the witness stand, fraudulent intent may be
2 established through the presentation of circumstantial evidence or
3 evidence of a pattern consistent with the fraud alleged. See, e.g., In
4 re Adeeb, 787 F.2d at 1343; In re Devers, 759 F.2d at 754; and In re
5 Johnson, 68 B.R. 193, 198 (Bankr. D. Or. 1986).

6 II. The Determination at Trial

7 The background of the Adversary Proceeding, briefly stated, is
8 as follows: The Sanderson Company had entered into a contract to sell
9 certain real property ("Real Property") to La Pine Village LLC ("La Pine
10 Village"), and La Pine Village signed a promissory note (the "LPV Note")
11 in the principal amount of \$1,500,000, bearing interest at 7% per annum,
12 and due and payable in full on November 29, 2006, payable to the
13 Sanderson Company. See Exhibit 1. Payment of the LPV Note was secured
14 by a deed of trust on the Real Property.

15 The Willms and Sanderson apparently had been involved in a
16 number of business transactions together over a number of years. On
17 October 6, 2006, Sanderson and the Sanderson Company needed operating
18 capital, and Sanderson convinced Willms to loan the Sanderson Company a
19 total of \$500,000, repayment of which was to be secured by the LPV Note.
20 A copy of a promissory note ("Promissory Note") made payable to the
21 Willms, in the principal amount of \$550,000, dated October 6, 2006,
22 bearing interest at 10% per annum, and signed by Sanderson in behalf of
23 the Sanderson Company, was admitted into evidence. See Exhibit 3.
24 However, Mr. Willms confirmed in his testimony that the actual loan
25 amount total was \$500,000. The Promissory Note provided that, "[t]he
26 total principal sum and all accrued interest shall be due and payable on

1 or before sixty days from the date of this note [October 6, 2006]."
2 Since the LPV Note was due and payable in full on November 29, 2006, the
3 apparent intent of the parties was that the Promissory Note would be paid
4 in full from proceeds of the LPV Note. See Exhibit 2.

5 Sanderson Company and [Sanderson] jointly secure a
6 \$550,000 loan plus interest from Hank Willms with a
7 note executed by Dominic Chan in the amount of
8 \$1,500,000 [the LPV Note]. This note is due and
payable on November 30, 2006 at which point Hank
Willms will be paid in full.

9 Id. Consistent with that intent, on or about October 11, 2006, the
10 Willms and Sanderson, in behalf of "Sanderson Company, Inc.," signed a
11 Security Agreement ("Security Agreement") granting the Willms a security
12 interest in the LPV Note.³ See Exhibit 4.

13 Unfortunately, the LPV Note was not paid in full on its due
14 date. What followed was a fairly typical "dance" between creditor and
15 debtor: Over a period of months through the spring of 2007, Mr. Willms
16 contacted Sanderson repeatedly to check on the status of payment on the
17 LPV Note and the prospects for payment of the Promissory Note. Although
18 Sanderson made himself scarce at times, he did advise Mr. Willms that
19 payment of the LPV Note had been delayed by the serious illness of La
20 Pine Village's principal, and he requested patience because the LPV Note
21 would be paid at "any time."

22
23 ³ Curiously, since the Security Agreement purported to give the
24 Willms a security interest in the LPV Note, arguably a negotiable
25 instrument, the Sanderson Company, Inc. was to "keep the LPV Note at its
26 principal place of business in Bend, Oregon." See Exhibit 4, Section 3.6
at p. 3. Eventually, however, Sanderson did deliver the LPV Note to the
Willms.

1 Finally, on or about August 27, 2007, Mr. Willms received a
2 "Sanderson Communities Inc." check from Sanderson in the amount of
3 \$507,117.33, which was deposited. See Exhibit A. One of the
4 frustrations of this adversary proceeding is the lack of any substantial
5 financial records from either side. The Willms did not submit any
6 financial records reflecting receipt of the \$507,117.33 payment or how it
7 was applied. However, Mr. Willms and his daughter, Kathy Locke, who
8 provided part-time help to the Willms, including bookkeeping services,
9 both testified that the \$507,117.33 payment was applied to an obligation
10 separate from the Promissory Note debt and that the Promissory Note debt
11 was never paid. That evidence was supported by Sanderson's testimony
12 that he asked for the original LPV Note back from Mr. Willms, and Mr.
13 Willms refused to give it to him.

14 The LPV Note eventually was paid in full, but the exhibits
15 submitted at the Trial tended to indicate that closing of the LPV Note
16 repayment transaction and reconveyance of the deed of trust on the Real
17 Property did not occur until on or about October 30, 2007. See Exhibits
18 5 and 6.

19 Sanderson testified that he paid off the Promissory Note with
20 proceeds from the LPV Note and thought the Promissory Note was paid in
21 full. Exhibit B (also admitted as Willms' Exhibit 7) includes an
22 informal accounting of Sanderson Communities receipts and disbursements
23 from September 26, 2002 through March 14, 2008. In August 2007, the
24 Exhibit B accounting reflects a debit for a \$500,000 "Note Payable"
25 obligation to Hank Willms and shows a disbursement of \$507,117.33, but
26 provides no further relevant detail.

1 The essence of the Willms' fraud allegations against Sanderson
2 in the Complaint is that Sanderson induced the Willms to loan the
3 \$500,000 to be repaid pursuant to the Promissory Note based on the
4 representation that the Willms would be repaid from the proceeds of the
5 LPV Note, and the Willms justifiably relied on that representation. The
6 Willms further allege that Sanderson had no intent to apply the LPV Note
7 proceeds to pay the Promissory Note when he made that representation, and
8 ultimately did not do so when the LPV Note proceeds finally were
9 received, to the Willms' damage in the amount of the unpaid Promissory
10 Note obligation.

11 Based on the evidence presented at the Trial, with the parties
12 taking diametrically opposed positions with little documentary support on
13 either side, the decision turned on the credibility of the parties, and I
14 did not find Sanderson credible based primarily on three points in the
15 evidence:

16 1) Sanderson testified that interest owing on the Promissory
17 Note was paid 100% of the time, on time. Yet, when asked on cross-
18 examination to identify any interest payments on the Promissory Note
19 reflected on the Exhibit B Sanderson Communities accounting, he could not
20 find any.

21 2) Sanderson testified that the \$507,117.33 payment to the
22 Willms in August 2007 was made from LPV Note proceeds. Yet, no evidence
23 was presented, either in terms of a closing statement or otherwise,
24 showing that LPV Note proceeds in the amount of \$500,000 or any other
25 amount were paid in August 2007. It was not credible in the
26 circumstances that Sanderson could not come up with some (any!)

1 documentation to verify where the funds to pay the Willms in August 2007
2 came from.

3 3) Exhibit 6 is a copy of a Letter of Indemnity signed by
4 Sanderson in behalf of the Sanderson Company to Amerititle on October 30,
5 2007, verifying, among other things, that the LPV Note was
6 "Lost/Misplaced/Destroyed." The Letter of Indemnity was provided in
7 conjunction with reconveyance of the deed of trust on the Real Property.
8 Sanderson signed the Letter of Indemnity verifying that the LPV Note was
9 lost, misplaced or destroyed at a time when Sanderson knew that the
10 original LPV Note was in the hands of the Willms, and Mr. Willms had
11 refused to turn it over to Sanderson.

12 As noted above, following the presentation of evidence at the
13 Trial, I made oral findings in favor of the Willms on their
14 § 523(a)(2)(A) claim for relief against Sanderson, but before judgment
15 was entered in favor of the Willms, Sanderson filed the Reconsideration
16 Motion.

17 III. Standards for Considering a Motion to Amend Findings or for a New
18 Trial

19 The Ninth Circuit has held that "[t]here are three grounds for
20 granting new trials in court-tried actions under [Civil] Rule 59(a)(2)
21 [Rule 9023]: (1) manifest error of law; (2) manifest error of fact; and
22 (3) newly discovered evidence." Brown v. Wright, 588 F.2d 708, 710 (9th
23 Cir. 1978). The standards governing a motion to alter or amend findings
24 or a judgment are essentially the same.

25 To succeed on her motion to alter or amend the
26 judgment, debtor must have: (1) presented newly
discovered evidence, (2) showed clear error, or

(3) showed an intervening change in controlling law. Clinton v. Deutsche Bank Nat'l Trust Co. et al. (In re Clinton), BAP No. WW-10-1285-JuMkH (BAP 9th Cir. Feb. 28, 2011), citing Marlyn Nutraceuticals, Inc. v. Mucos Pharma GmbH & Co., 571 F.3d 873, 880 (9th Cir. 2009). See Hansen v. Moore (In re Hansen), 368 B.R. 868, 878 (BAP 9th Cir. 2007) ("Reconsideration under [Civil Rule] 59(e), applicable via Rule 9023, is appropriate only if the moving party demonstrates (1) manifest error of fact; (2) manifest error of law; or (3) newly discovered evidence." (citations omitted)).

When "newly discovered evidence" is alleged as the basis for granting such motions, the following standards generally apply:

(1) [T]he newly discovered evidence must have been discovered after judgment, and the movant must have been excusably ignorant of the facts at the time of trial despite due diligence to learn about the facts of the case; (2) the evidence discovered must be of a nature that would probably change the outcome of the case; and (3) the evidence must not be merely cumulative or impeaching. 12 Moore's Federal Practice (1998 3rd ed.) at § 59.13[2][d][ii]-[vii]. See also Jones v. Aero/Chem. Corp., 921 F.2d 875, 878 (9th Cir. 1990) (similar test).

Krommenhoek v. Covino (In re Covino), 241 B.R. 673, 679 (Bankr. D. Id. 1999).

IV. The Evidence Supporting Amended Findings

In support of the Reconsideration Motion, Sanderson submitted his affidavit ("Sanderson Affidavit") identifying a copy of a document ("Deposit Document") showing a deposit to an account with Bank of the Cascades in the amount of \$500,000 on August 27, 2007. See Exhibit E. Typed independent of the deposit slip on the Deposit Document are notations from the "AMERITITLE - ESCROW TRUST ACCOUNT" stating that

1 Sanderson Company was receiving payment of the balance of a loan, Escrow
2 No. BA095278A, in the amount of \$500,000. The "BUYER" with respect to
3 the subject escrow is identified as La Pine Village, and the Escrow
4 Officer is identified as Libby R. Hervey.

5 In the Sanderson Affidavit, Sanderson states that following the
6 Trial, he found the Deposit Document in certain personal income tax files
7 in boxes that Sanderson had picked up from his accountant, when he
8 noticed "some Sanderson Community, Inc. files, in the personal files
9 box."

10 In their initial response to the Reconsideration Motion (Docket
11 Nos. 46 and 48), the Willms argue with some justification that Sanderson
12 did not act with appropriate diligence to find the Exhibit E Deposit
13 Document, which should have been located and exchanged during discovery
14 and presented at the Trial. Sanderson might have been able to locate the
15 Deposit Document prior to the Trial and presented it with his other trial
16 exhibits, but in the circumstances of this case, where both sides
17 appeared to be somewhat "document challenged," I am not prepared to
18 disallow Sanderson from presenting the Deposit Document as evidence in
19 support of the Reconsideration Motion. Exhibit E has been properly
20 authenticated through the Sanderson Affidavit, and I will admit the
21 Exhibit E Deposit Document as evidence relevant to resolution of the
22 Adversary Proceeding.

23 The Willms further submitted the Declaration of Catherine A.
24 Locke Regarding Interest Payments (Docket No. 52), in which Ms. Locke
25 stated that the Sanderson Communities Inc. check in the amount of
26 \$507,117.33, dated August 27, 2007 (see Exhibit A), was not a payment on

1 the Promissory Note but in fact was an option payment with respect to an
2 entirely different transaction.

3 At a preliminary hearing on the Reconsideration Motion on
4 November 30, 2010, I set a deadline of January 7, 2011, for the Willms to
5 submit further evidence in opposition to the Reconsideration Motion. See
6 Docket No. 50. Following a further hearing, I extended the deadline for
7 the Willms to submit further evidence in opposition to the
8 Reconsideration Motion to February 7, 2011. See Docket Nos. 57 and 58.

9 On February 7, 2011, counsel for the Willms filed his affidavit
10 ("Hostetter Affidavit"), authenticating a number of documents from the
11 LPV Note escrow file at Amerititle and a portion of the deposition of Ms.
12 Libby Hervey, the escrow officer. See Docket No. 60. Some of the
13 authenticated exhibits to the Hostetter Affidavit tend to show that
14 substantial payments were made on the LPV Note in the spring of 2007 that
15 were not paid over to the Willms in spite of Sanderson's promises. See
16 Docket No. 60, Hostetter Affidavit, Exhibits 1-4. However, other
17 authenticated exhibits tend to show that a \$500,000 payment on the LPV
18 Note was due and payable on or about August 27, 2007. See Docket No. 60,
19 Hostetter Affidavit, Exhibit 5, at p. 1, Exhibit 7, at p. 1. In
20 addition, Exhibit 9 to the Hostetter Affidavit includes a copy of a
21 \$500,000 check, dated August 27, 2007, from Amerititle to the Sanderson
22 Company, representing payment proceeds from the LPV Note, and a copy of a
23 communication from Ms. Hervey to Sanderson confirming Sanderson's receipt
24 of the check. See Docket No. 60, Hostetter Affidavit, Exhibit 9.

25 On February 8, 2011, counsel for Sanderson filed his own
26 supplemental declaration ("Erwin Declaration"), authenticating a

1 communication from Sanderson Co., Inc. to Ms. Hervey, dated November 6,
2 2006, attaching a copy of the Security Agreement, and stating, "So we owe
3 Hank \$500,000 plus interest @ 14% when the [LPV Note] is paid in full."
4 See Docket No. 61, Erwin Declaration, Exhibit A. Counsel for Sanderson
5 also authenticated further portions of Ms. Hervey's deposition, including
6 statements as to Ms. Hervey's understanding that there was a \$500,000
7 obligation to Mr. Willms as of November 2006, but no escrow for that
8 obligation was established. See Docket No. 61, Erwin Declaration,
9 Exhibit B.

10 In reaching my decision on the Reconsideration Motion, I have
11 considered both the Hostetter Affidavit and the Erwin Declaration, and
12 all exhibits attached.

13 After considering all of the parties' supplemental evidence
14 submitted subsequent to the Trial, I find that the \$500,000 payment on
15 the LPV Note, made on August 27, 2007, was used by Sanderson to fund most
16 of the Sanderson Communities Inc. \$507,117.33 payment to the Willms,
17 likewise by check dated August 27, 2007. There is no evidence that
18 Sanderson obtained the \$500,000 from any other source at that time. The
19 fact that Sanderson used \$500,000 from LPV Note payments to pay the
20 Willms negates any intent by Sanderson from the outset of the Promissory
21 Note transaction not to pay the Willms from proceeds of the LPV Note. As
22 a bottom line matter, how could I find that Sanderson induced the Willms
23 to loan \$500,000 based on a fraudulent representation to pay the
24 Promissory Note from proceeds of the LPV Note when the evidence is now
25 clear that Sanderson caused \$500,000 in LPV Note proceeds to be paid to
26 the Willms? The \$507,117.33 payment in August 2007 may not have paid all

1 interest accrued on the Promissory Note debt and owing to the Willms, but
2 if there is an interest deficiency, it represents a breach of contract
3 obligation of the Sanderson Company, and based on the evidence before me,
4 I do not find that it is attributable to fraud by Sanderson.

5 Accordingly, the new evidence from the parties causes me to reexamine and
6 reverse my finding of fraudulent intent on the part of Sanderson when he
7 induced the Willms to loan the Sanderson Company \$500,000, as documented
8 by the Promissory Note and secured by the LPV Note.

9 Conclusion

10 Based on the foregoing findings, I conclude that the
11 Reconsideration Motion should be granted and that Sanderson is entitled
12 to a judgment of dismissal of the Adversary Proceeding. Mr. Erwin should
13 prepare and submit an order and judgment consistent with this Memorandum
14 Opinion within ten days following its entry.

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17 cc: Lawrence W. Erwin
18 D. Zachary Hostetter
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